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SUPREME COURT OF THE UNITED STATES.

**OCTOBER TERM, 1932**

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# No. 104

BANKERS POCAHONTAS COAL COMPANY,
PETITIONER,

*vs.*

COMMISSIONER OF INTERNAL REVENUE.

---

# No. 105

D. J. F. STROTHER, PETITIONER,

*vs.*

COMMISSIONER OF INTERNAL REVENUE.

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## PETITIONERS' BRIEF.

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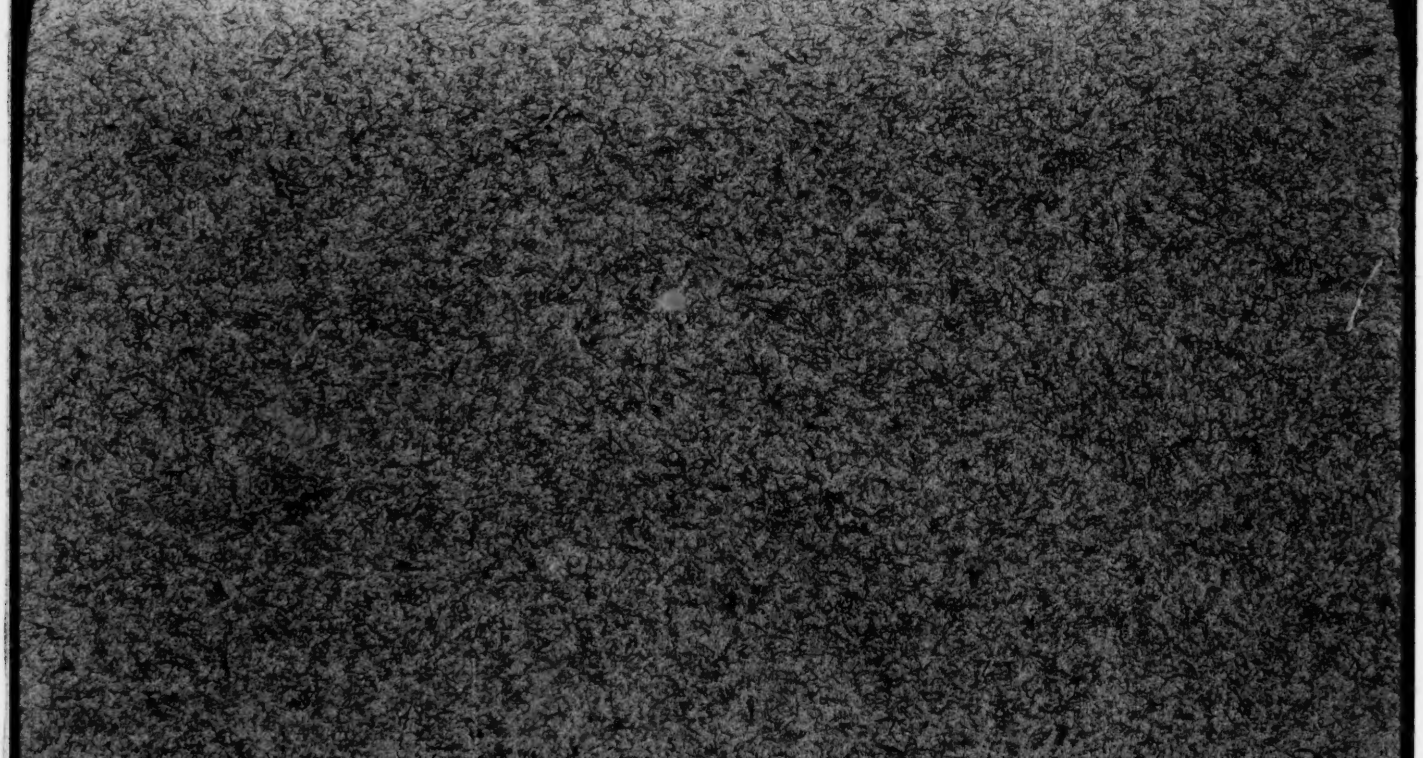

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## PETITIONERS' BRIEF.

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### Grant of the Writs.

Writs of certiorari to the Circuit Court of Appeals, Fourth Circuit, were granted herein on October 10, 1932, and the two cases, being related, should be heard together.

**Opinions Below and Jurisdiction.**

The opinion of the Circuit Court of Appeals rendered January 27, 1932, is reported in 55 F. (2) 626 (R., pp. 120-134); the findings of fact and opinion of the United States Board of Tax Appeals, rendered January 22, 1930, are reported in 18 B. T. A. 901 (R., pp. 30-57). The jurisdiction herein has been shown heretofore (Petition for writ and supporting brief (pp. 1, 2, 13)).

**The Basic Issues.**

Whether proceeds of a sale of coal in place effected in 1902 and collected subsequent to the Sixteenth Amendment under contracts not providing for production of any maximum or minimum tonnage, or for any definite payments, constitute taxable net income under the several Revenue Acts.

Whether the statutory depletion allowances available to a lessor are allowable to a vendor of coal in place who has severed his interest in the depletable mineral, or to his assignee.

Whether the statutory depletion allowances available to a lessor are applicable to payments for coal in excess of the payment for coal actually mined within a taxable year.

Whether a depletion allowance determined in prior litigation between a taxpayer and Collector of Internal Revenue, who was defended therein by the Commissioner of Internal Revenue, constitutes *res adjudicata* in these later proceedings between the same taxpayer and the Commissioner of Internal Revenue.

**Statement of the Case.**

Income tax deficiencies of $39,171.05 against petitioner Company, for the years 1920 to 1926, and of $5,806.11, against petitioner Strother, are here involved.

In 1901 and 1902, the fee owner of West Virginia acreage, valueless except for its coal content (R., p. 39), demised and let said coal content to various mining operators. The instruments of demise and letting were originally prepared by petitioner Strother as attorney for said fee owners, and their form is that prevailing in the West Virginia coal fields, adopting and following the Pennsylvania form of contract as introduced by Pennsylvanians who were largely instrumental in the early development of the West Virginia coal fields. One of the instruments, agreed upon as typical of all of them, is in evidence herein (R., p. 40). The Board of Tax Appeals admitted (R., p. 49), and the lower court herein expressly held (R., p. 123), that said instrument constitutes a sale of coal in place under the State law of West Virginia and of Pennsylvania.

In 1912, petitioner Company was organized and acquired, and has since held, the fee title to said acreage subject to said instruments, and also the beneficial interest of the former fee owner in said instruments. By said typical instrument the mining operator in 1901 agreed to pay "10 cents per ton for each and every ton of coal mined", with "$5,000 for each and every year as a minimum" (R., pp. 40-41),

and the grantor retained no interest in said coal content. Petitioner Company, having no other business, has, since 1912, collected the contract payments each year (R., p. 90), and distributed them, upon a cash basis (R., p. 46), to its stockholders, of whom petitioner Strother is representative, excepting amounts necessary to meet the taxes herein involved which were retained and paid out at the first opportunity (R., p. 72).

The operators since 1901 and 1902 have possessed and mined the coal (R., pp. 39, 90).

Neither petitioner Company, nor the original fee-owner, were ever in the mining business; petitioner Company having acquired, in 1912, the rights to the subsequent payments for coal sold in 1902, never owned any coal, and, in subsequent years, only collected the deferred proceeds of sale of real estate effected and completed in 1901.

After adoption of the Sixteenth Amendment and enactment of the Revenue Acts, both petitioners in their tax returns disclosed said payments and distributions as being the proceeds of sales of coal in place effected before the Amendment, and consequently not subject to tax (R., pp. 38, 46, 49). Ignoring the state law of property (R., p. 92), the Commissioner of Internal Revenue for the years 1914-1919 held petitioner Company and the operators for Federal tax purposes were lessor and lessees, and said payments were gross income but that every 10-cent payment should be reduced by a statutory depletion allowance of 3.6 cents, representing the non-taxable return of capital or in-

vested property therein received, to ascertain taxable net income. Said Commissioner assessed and required petitioner Company thereby to pay taxes of about $6,000 to the proper collector upon the alleged net income so ascertained (R., pp. 47, 90). Petitioner Company, thereupon, sued said Collector in the United States District Court in West Virginia to recover said taxes for cause, either that same were the non-taxable proceeds of purchase money contracted for before the Sixteenth Amendment, existing unconditionally on March 1, 1913, and payable thereafter (R., p. 47), or alternatively, if petitioner Company was a lessor and not a vendor, that the depletion unit measuring return of capital or invested property should be fixed in a greater amount (R., p. 47). In said action the Commissioner of Internal Revenue by his own counsel of record, and the District Attorney defended the Collector (R., p. 47). Therein, petitioner Company obtained a final judgment fixing a depletion unit of 5 cents per ton, with a consequent recovery of a substantial part of the taxes, which judgment was duly satisfied and has since remained in full effect (R., p. 47).

Contemporaneous with and subsequent to said litigation, said Commissioner determined income taxes of about $40,000 (R., p. 38) against petitioner Company for the years 1920-1926, holding petitioner Company as a lessor was only entitled to depletion of 3.6 cents per ton, for 1920 to 1923, inclusive, and an average of 2.6 cents per ton of coal paid for in 1924 to 1926, inclusive (R., p. 75), and refusing to give any effect to the 5-cent depletion rate established by said

judgment (R., pp. 46, 47, 48) except in the computation of invested capital for 1920.

As to petitioner Strother, the Commissioner increased his net income for the several years by his entire receipts from said purchase money distributions, without any allowance for non-taxable depletion reserves received in the distributions, and determined the resulting deficiencies of tax against him (R., pp. 48, 49).

Petitioners, by their appropriate appeals, petitioned the United States Board of Tax Appeals for redeterminations of said several deficiencies, claiming petitioner Company was neither the owner nor lessor of any mine, neither petitioner was taxable upon purchase money payments derived from sales of coal in place effected before March 1, 1913, and payable thereafter without income increment, and claiming—in the alternative—that if the payments were taxable after allowance of depletion deductions, the 5-cent depletion rate established in previous litigation between the parties was *res adjudicata* thereof, and should be allowed instead of the 3.6-cent rate (R., pp. 7, 8, 18, 19). The Board of Tax Appeals, without denying that the demise of 1902 effected a sale of coal in place according to the property rule of West Virginia (R., p. 49), held: *First,* The contracts for Federal tax purposes, under the rule of *Hirschi* v. *United States, infra,* established the relation of lessor and lessee between petitioner Company and the operator, making the payments gross income subject to depletion allowances (R., p. 50); *Second,* That bonuses, or minimum payments in excess of payment of coal actually mined in

the year, are gross income not subject to depletion allowances (R., pp. 49, 70); and *Third,* The depletion rate of 5 cents per ton determined in previous litigation between the parties over the same subject matter was not thereby allowances to petitioner Company (R., p. 52), and said Board determined total deficiencies of $39,171.05 against petitioner Company (R., p. 71), and thereby of $5,806.11 against petitioner Strother.

By their petitions for review (R., p. 73) petitioners applied to the Circuit Court of Appeals for the Fourth Circuit for review of said Board decision, alleging as errors: (1) That such payments were not taxable income (R., p. 81); (2) Alternatively, that the adjudged 5-cent depletion rate was applicable (R., p. 81); and (3) That any depletion was allowable upon coal paid for and not merely upon coal mined (R., p. 82); and, (4) As to petitioner Strother, that he received no taxable income, or if so, that all depletion reserves should be eliminated from the distributions made to him.

The Circuit Court of Appeals held, *First,* the contracts of 1902 effected sales of coal in place (R., p. 123); *Second,* that, nevertheless, Congress intended to tax said sales proceeds by returning capital through lessor depletion allowances (R., p. 124); *Third,* that the West Virginia judgment was not binding upon the Commissioner and hence did not establish the 5-cent depletion rate (R., p. 127); and *Fourth,* affirmed the Board determination whereby the minimum annual payments in excess of payment for coal actually mined were held to be bonuses returnable as gross income without allowance of depletion deductions against

same (R., p. 132). It further held its decision of the Company case (R., p. 132) would substantially determine the Strother case. Incidental issues not here of importance are omitted as immaterial.

Thereupon, writs of certiorari were granted herein to each petitioner.

**Errors to be Urged.**

The Board and court below erred (references to opinion of each):

1. In deciding purchase money installments of the proceeds of sales of coal in place effected in 1901 and 1902, when paid by the grantees in the years subsequent to the Sixteenth Amendment, are taxable income to petitioner Company, who, at and before March 1, 1913, owned the unconditional claim and right then existing to receive the unpaid part of said purchase money in the several subsequent years, and thereafter merely collected same (R., pp. 49, 124).

1(*b*). In deciding the distribution by petitioner Company of said proceeds to its stockholder Strother is taxable income to him (R., pp. 57, 135).

2. In deciding Congress intended by the Revenue Acts to tax said proceeds of sale (R., p. 124).

3. In deciding the grantor of coal sold in place, or his assignee, is a lessor entitled to the depletion allowances prescribed for a lessor (R., pp. 51, 124) by the Revenue Acts.

4. In deciding that the excess amount of minimum payment received in any year from the grantee over

the payment therein made for coal actually mined within the year is not subject to any depletion allowance (R., pp. 49, 134).

5. In deciding a judgment in favor of petitioner Company against a Collector, who was defended of record in the proceeding by the Commissioner of Internal Revenue, acting through his official counsel, and which judgment involves the same subject matter of statutory depletion allowances as is presented herein, and was duly paid by the United States, is not *res adjudicata* herein against said Commissioner as to the amount of depletion, if any, allowable to petitioner Company (R., pp. 52, 127).

**Summary of Argument.**

The primary position of petitioners is that the proceeds of the sales of coal in place, effected before the Sixteenth Amendment was enacted, are not income subject to tax under the subsequent Revenue Acts when collected thereafter.

Their secondary or alternative position involves the sufficiency of statutory depletion allowances, if said proceeds subsequently received are royalties of a lessor subject to depletion. Petitioners contend any applicable depletion rate must be applied to the entire proceeds and not to the part of same only representing coal mined within the year. They further contend any depletion should be at the rate previously adjudged in litigation between the parties.

Decision of these issues in the case of petitioner Company will apply to and decide the case of petitioner Strother.

## ARGUMENT.

**Proceeds of the sale of mineral in place effected before the XVI Amendment and collected thereafter are not taxable as income to either petitioner under subsequent Revenue Acts, because they are only the returns from a claim or right unconditionally existing on and before March 1, 1913, and thereafter payable.**

**To hold otherwise conflicts with the XVI Amendment and judicial precedents.**

Petitioners stand first upon the proposition of law announced by the Circuit Court of Appeals, to wit:

> "We shall assume for purposes of this decision that the law of West Virginia is that a mining lease constitutes a sale of the mineral in place."

In support thereof, the lower Court makes reference to *Coal Company* v. *Overholt,* 81 W. Va. 427, 424; *Feather* v. *Baird,* 85 W. Va. 267; *Urpman v. Lowther Oil Co.,* 53 W. Va. 501; *Toothman* v. *Courtney,* 62 W. Va. 167, and *Smith* v. *Root,* 66 W. Va. 633.

It follows the original fee owner sold the coal in place in 1901 and 1902 for a price payable thereafter, and petitioner Company in 1912 succeeded to and since holds the right to collect the unpaid purchase money in subsequent years. Said right involved no payment of interest or profit. The subsequent proceeds are clearly not subject to income tax, being within the definition of Article 90 of Regulations 45, 62, 65 and 69, issued by the Commissioner of Internal Revenue in

the years 1918 to 1926, inclusive. Said Article 90 provides:

> "Income accrued prior to March 1, 1913.—Any claim existing unconditionally on March 1, 1913, whether presently payable or not and held by a taxpayer prior to March 1, 1913, whether evidenced by writing or not, and all interest which had accrued thereon before that date, do not constitute taxable income, although actually recovered or received subsequent to such date. Interest accruing on or after that date is taxable income. Where an interest-bearing claim held on February 28, 1913, is paid in whole or in part after that date, any gain derived from the payment of the claim is taxable."

Here it may be noted that the foregoing Article has been broadened beyond "any claim existing unconditionally" by judicial interpretation, and in *Commissioner* v. *Brown*, 54 F. (2d) 563 (C. C. A. 1) such claim, *existing as a conditional obligation*, on and before passage of the Sixteenth Amendment, is held not to be income, when subsequently collected, upon authority of *Burnet* v. *Logan*, 283 U. S. 404, which latter decision of this Court is a sufficient touchstone to solve the present cases. Nor because the typical instrument provides a possible forfeiture upon defaults by the operators, can it be inferred the instrument creates a conditional obligation defeating the transfer of interest effected through the sale in place, for in *Crile* v. *Commissioner*, 55 Fed. (2d) 804 (C. C. A. 6) (certiorari denied October 10, 1932), wherein a sum of money was paid as part consideration of a lease, the Court says:

> "Where, there is an intent to create in the 'lessee' an interest in the property itself—as by way of purchase—even though that interest may be forfeitable by failure to perform conditions subsequent, and this intent is made manifest by the instruments duly executed to carry it into effect, the attending payment is a return of capital, and should be so regarded, at least prior to forfeiture and reversion."

It follows petitioner Company, as assignee of its predecessor who effected the sale, collects capital and no more in receipt of payments made since 1912 and after the Sixteenth Amendment.

The adoption of the Amendment makes March 1, 1913, when it became effective, the line of division between income that is not or is taxable under the subsequent Revenue Acts levying income taxes without apportionment, and it follows that any income previously existing was and is not subject to subsequent income taxes (*Lucas* v. *Alexander,* 279 U. S. 573, 577). This principle expressed in the foregoing Article has very recently found terse statement again by this Court in *Old Colony R. R. Co.* v. *Commissioner,* 284 U. S. 552, 557:

> "That income had become capital prior to the adoption of the Amendment and could not be reached by a subsequent income tax act."

Stating the proposition of fact more precisely in reference to the present case, we submit this Court said in *Strattons Independence v. Howbert,* 231 U. S. 399, 414-15:

> "The sale outright of a mining property might fairly be described as a mere conversion of the capital from land into money."

whereby, in this case, the subsequent collection of money resulting from a sale of property made before the Amendment became effective is a receipt of capital and not of income subject to tax under the subsequent Revenue Acts.

In the lower Courts, in similar situations, it has often been so decided. Thus, in *Saunders* v. *Commissioner,* 29 F. (2d) 832 (C. C. A. 3), an inventor, in 1911, sold an invention covered by a patent application, and, in 1920, received $25,000 in payment therefor, and it is held same was a return of capital and not taxable income. In *United States* v. *Guinzberg,* 278 F. 363 (C. C. A. 2), a dividend declared before March 1, 1913, is held not taxable income when thereafter received. In *Park* v. *Gilligan,* 293 Fed. 129, a claim for damages existing before and on March 1, 1913, and realized by payment in 1916 is held not to be income when distributed in dividends to stockholders. In *Schneider* v. *Duffy,* 43 F. (2d) 642, taxpayer, in 1916, agreed to accept 1,500 shares of stock deliverable 300 shares per year as consideration for his certain agreements, and it is held any income from the transaction was received in 1916 and not when the stock was delivered.

Petitioner Company is certainly entitled to return of its capital before taxable income is realized (*Doyle* v. *Mitchell,* 247 U. S. 179, 185), but the capital value on March 1, 1913, of its right to receive the purchase

money payable thereafter is not definitely known and cannot be ascertained as a matter of market value for reasons given in *Bedell* v. *Commissioner,* 30 F. (2d) 622, 624 (C. C. A. 2), as follows:

> "If a company sells out its plant for a negotiable bond issue payable in the future, the profit may be determined by the present market value of the bonds. But if land or a chattel is sold, and title passes merely upon a promise to pay money at some future date, to speak of the promise as property exchanged for the title appears to us a strained use of language, when calculating profits under the income tax.
>
> "* * * it is absurd to speak of a promise to pay a sum in the future as having a 'market value', fair or unfair. Such rights are sold, if at all, only by seeking out a purchaser and higgling with him on the basis of the particular transaction."

In *Burnet* v. *Logan,* 283 U. S. 409, 412, this Court held that the market value of an agreement to pay to taxpayer a certain sum per ton of extracted ore could not be determined, saying:

> "The lease contract did not require production of either maximum or minimum tonnage, or any definite payments. * * *
>
> "* * * a promise to pay indeterminate sums of money is not necessarily taxable income. 'Generally speaking the income tax law is concerned only with realized losses, as with realized gains.'" *Lucas* v. *American Code Co.,* 280 U. S. 455, 449.

In *Burnet* v. *Logan* a depletion rate computed upon conjecture is expressly rejected, and the 3.6 cent rate herein is therefore to be denied. Its basis is in substance the assumption that the present value of $34,000 being payment at the rate of 10 cents per ton receivable during each of 40 years after March 1, 1913, is $510,000, or 3.6 cents per ton on that date. But such assumption is not justified for no average receipt per year can be determined, and without an average annual receipt there can be no computation. No average annual receipt can be known for no maximum payment is provided, and the minimum is evidently not the measure of the receipt. Therefore, no actual market or fair value as of March 1, 1913, can be known for the contingencies of receipt remain undiscovered. Other material contingencies, default of the operator, possible acceleration of payment, uncertainty of production, and similar details, are entirely evident, and make the assumed value entirely fantastic, where petitioner Company is entitled to reality of computation.

The lower Court says an allowance of 3.6 cents per ton would return to taxpayer a total of $1,353,911.11 of capital upon the tonnage estimated in the stipulation as existing on March 1, 1913. The record shows (R., p. 44) petitioner Company through 1919 had only received $244,094.62, and that the capital value of $510,000 on March 1, 1913, does not include two coal seams which were being mined when the valuation was made (R., pp. 93, 102). This Court says in *Burnet* v. *Logan* (p. 412), a taxpayer is entitled to the return of capital before it may be charged with taxable income,

and where the capital is not in fact returned there is no taxable income.

The self-evident conjectural and speculative nature of any computed value on March 1, 1913, of the purchase money contracts is probably best visualized by reference again to the character of payment which justifies such computation. Such a comparative exists in *Kosmeryl* v. *Commissioner,* 25 F. (2d) 87 (C. C. A. 7), relating to sale of a mineral property before March 1, 1913, for a price payable in 40 equal installments, evidenced by non-interest bearing negotiable notes; and therein the present value of the notes on March 1, 1913, is declared to be their capital asset value and subsequent receipts in excess thereof to be taxable income. This accords with the statement of Judge Hand in *Bedell* v. *Commissioner, supra,* distinguishing such a case from one, such as the present case, involving a mere promise to pay money at a future date.

Herein, as in *Burnet* v. *Logan,* 42 F. (2d) 193, 196, the reasoning of the Circuit Court subsequently approved by this Court is entirely applicable where the duration of the mining operations, tonnage to be mined and receipts in any year, are all uncertain and therefore afford no basis of computation. The Court said:

> "The ultimate duration of the life of a mine is uncertain or unknown and forms no basis on which to formulate a definite financial policy. Hoover's Principles of Mining, p. 44. See also *Pacific Gas Co.* v. *San Francisco,* 265 U. S. 403. Moreover, the division of percentage as a return of capital and that of income is an estimate based upon assumptions and uncertainties. It is an unsafe guide either to determine ex-

> changeable value or the fair market value. *O'Meara* v. *Commissioner,* 34 F. (2d) 390 (C. C. A. 10.)"

Therefore, an income situation not being reasonably presented herein, it follows that Article 90 reasonably says taxable income or gain is not received when the claim is collected subsequent to the Amendment. This accords with the principles of *Old Colony R. R. Co.* v. *Commissioner,* 284 U. S. 552, 560, 561, that a construction of the taxing act most favorable to taxpayers in cases of doubt is proper and that:

> "The plain obvious and rational meaning of a statute is always to be preferred to any curious, narrow minded sense that nothing but the exigency of a hard case and the ingenuity and study of a powerful intellect would discover."
> * * *
> "* * * the words of the statute do not refer to some esoteric concept derived from subtle and theoretic analysis."

Taxation of any part of said contract proceeds as income being not authorized by the Sixteenth Amendment, or the subsequent judicial precedents, the contrary decision of the lower Court is material error.

**Under subsequent Revenue Acts Congress never intended to tax the proceeds of this sale in place effected before the Amendment when thereafter collected, or to declare the vendor or his assignee is entitled to the statutory depletion allowances provided for a lessor of coal mines.**

After holding the typical instrument constitutes a sale of coal in place, the lower court declares (R., p.

122) this Court has decided a mining lease is more than a sale and delivery of property, in that it involves a manufacturing process, and that royalties are income of the business and as such subject to taxation. It concludes Congress intended to tax said proceeds—called royalties in its opinion—after deduction therefrom of a reasonable allowance for depletion.

Such declaration of the lower Court is erroneous in at least three aspects.

*First,* What this Court may have decided about a mining lease is not decisive where a mining property is sold, and no property interest is retained.

*Second,* Loosely terming the sale proceeds as royalties, omits their meaning.

In *Ferguson* v. *Commissioner,* 45 Fed. (2d) 573, (C. C. A. 5), another case of sale of mineral in place, involving the propriety of statutory depletion either against a seven-eighths interest sold in place, or against the remaining one-eighth interest receivable when produced as the sale consideration, or against both, it is said:

> "Royalties represent the retained interest of the lessor or the vendor in the property or minerals which he receives from time to time as revenues under the contract. He (Ferguson) did not convey that interest under the deed or lease, but provided that he should receive a fraction of the minerals themselves."

The real meaning of the receipts herein as proceeds of a sale, and not as royalties from any interest retained in the property, was further available to the

lower court by reference to and recognition of the similar situation, excepting the provision therein for additional payment of the value of part of the mineral produced, described by this Court in *Group No. One Oil Corporation* v. *Bass,* 283 U. S. 279, 281, another case of sale in place, as follows:

> "*The leases conveyed all the oil and gas* in granting the right to find, produce, and appropriate all of them, *in consideration of the payment of stipulated sums and also the value of a stated fraction of the oil and gas produced.*" (Italics supplied.)

When the typical contract herein granted the operator "*the sole and exclusive privilege of mining and coking coal*" it likewise (paraphrasing the above quotation) "*conveyed all the coal in granting the right to find, produce, and appropriate all,*" as said by this Court, and there was no retained interest.

*Third,* and lastly, the vendor, or assignee, thereby never got into the mining business nor became interested in its manufacturing processes, for, since 1901 or 1902, the vendor owned neither coal nor interest therein, and petitioner Company has never owned any coal or interest in coal.

The conclusion of the lower court that Congress intended to tax said proceeds after allowing depletion deductions, considered alone, is equally without foundation.

In the first place, Congress could not tax the proceeds of the capital claim for reasons previously given. To do so violates the constitutional provisions which

limit the power of Congress to tax income and no more, under the Sixteenth Amendment.

This Court said in *Nichols* v. *Coolidge,* 274 U. S. 531, 541:

> * * * "under the mere guise of reaching something within its powers, Congress may not lay a charge upon what is beyond them. Taxes are very real things and statutes imposing them are estimated by practical results."

In the second place, a sale in place being a severance of the estate of the grantor, such grantor is not a lessor, and, as depletion is allowed by Congress only upon the taxpayer's interest in the mine, the grantor has no depletable interest after the sale in place was effected.

A sale of mineral in place effects a complete severance of the estate conveyed (*Group No. One Oil Corporation* v. *Bass,* 283 U. S. 279), wherein certain alleged immunities of a grantor were declared severed lost to its grantee by a sale in place, as distinguished from their preservation and benefit to a lessee, under the same contract in a state not recognizing the rule of sale in place, in the later decision of *Burnet* v. *Coronado Oil and Gas Co.,* 285 U. S. 393. The payments by the vendee for coal bought in place are capital expenditures and not the deductible rentals of a lessee (*Jefferson Gas Coal Co. v. Commissioner,* 52 F. (2) 120 (C. C. A. 3)).

The Congress in the Revenue Acts provides for allowance of depletion deductions only to the owner, or to the lessor and lessee of a mine (Cf. Statutes quoted in Appendix), saying:

> "* * * That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (*or the taxpayer's interest therein*) on that date shall be taken in lieu of cost up to that date. (Section 234(*g*), R. A. of 1918.)"

Hence, Congress allows no depletion to a vendor, or his assignee, after sale of his interest in the property. The depletion deduction is not a matter of right, and express authority therefor must be found in the Revenue Acts (*Stanton* v. *Baltic M. Co.*, 240 U. S. 103; *Burnet* v. *Thompson Oil and Gas Co.*, 283 U. S. 301). The essential statutory test, either for depletion or depreciation is the interest of the claimant in the property for as said of a statutory deduction for depreciation, in *Weiss* v. *Wiener*, 279 U. S. 333, 336:

> —"he must show an interest in the property and a present loss to make the statute apply."

In *Murphy Oil Co.* v. *Burnet*, 55 F. (2d) 17 (C. C. A. 9), we read:

> "The statute, with reference to depletion * * * is a special one * * * involving the production of oil and minerals from mines, and *the consequent return of capital by the owners of interests therein*, and controls over other general provisions of the law in regard to the return of capital investment." (Italics supplied.)

In *Darby Lynde Co.* v. *Commissioner*, 51 F. (2d) 32 (C. C. A. 10) (Cert. denied 52 S. C. 40), a discovery value available to a partnership as a basis of depletion

under the statute is denied to a successor corporation created and owned by the partners. In *Pugh* v. *Commissioner*, 49 F. (2d) 76 (C. C. A. 5) (Cert. denied, 52 S. C. 22), a taxpayer is held to have lost his right to depletion of his lease interest after conveyance of such interest because he thereby became a lessee without investment. In *South Vernon Oil Co.* v. *Hopkins*, 49 F. (2d) 1028 (C. C. A. 5), we have the same conclusion and the reason stated that the sale severed the depletable interest in the property.

Third, in case of a severance of interest, of a sale, the Congress has in the Revenue Acts made other provisions, entirely apart from depletion, for taxing any capital gain. Thus, in Texas, where, as in West Virginia, the State rule of sale of mineral in place governs such matters, a taxpayer leased seven-eighths of the mineral, while retaining the other one-eighth interest, and received a cash bonus and royalties. That he thus sold the seven-eighths interest in place, making his bonus receipt subject to the special tax rate upon a capital gain, and that only his retained interest remained subject to depletion is the decision in *Ferguson* v. *Commissioner*, 45 F. (2d) 573 (C. C. A. 5). In *Harmel* v. *Commissioner*, 56 F. (2d) 153 (C. C. A. 5), the same conclusion is reached upon authority of *Group No. One Oil Corporation* v. *Bass*, and other decisions of this Court. In *Alexander* v. *King*, 46 F. (2d) 235, in a very similar case, the capital gain provision is held inapplicable because the Oklahoma rule of property does not recognize a sale of mineral in place and ascertains the parties to be lessor and lessee. (Cf. *Burnet* v. *Coronado Oil and Gas Co.*, 285 U. S. 393 (*supra*).)

Lastly, the ruling of the lower court herein is not logical in results. If notwithstanding a sale in place, the vendor is held entitled to depletion, although he has parted with the property, this conflicts with the established rule that depletion is incident to the property interest. It deprives the vendee, as the sole owner of the property, of some part of its depletion deduction, and converts his capital payments of installments of the purchase money into rentals in the hands of the recipient. It creates an allowance not authorized by law.

The lower court (R., p. 124), after finding petitioner Company stands in the shoes of a grantor and not of a lessor as the result of the sale in place, nevertheless decides that petitioner is a lessor to which the subsequent payments are income, buttressing this decision (R., p. 124) with the statement:

> "The Federal courts must respect the local laws of property laid down by the courts of the State, but the power of Congress to tax must be judged by the realities of the situation and not by the logic of State rules of property, pushed inexorably to their extreme."

We would point out wherein this Court disapproves this statement.

Such opinion conclusion flows from discussion of earlier decisions of this Court (*Stanton* v. *Baltic Mining Co.*, 240 U. S. 103; *Strattons Independence* v. *Howbert*, 231 U. S. 399; *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503), with special emphasis upon cases in which certiorari was denied (R., p. 123) (*Rosen-*

*berger* v. *McCaughn*, 25 F. (2d) 699; *Hirschi* v. *United States*, 67 Ct. Cl. 637; *Berg* v. *Commissioner*, 33 F. (2d) 641; *Burkett* v. *Commissioner*, 31 F. (2d) 667; *Alexander* v. *King*, 46 F. (2d) 235), and the statement (R., p. 125), that later decisions of this Court (*Tyler, Admr.*, v. *United States*, 281 U. S. 497; *Crooks* v. *Harrelson*, 282 U. S. 55; *Poe* v. *Seaborn*, 282 U. S. 101, omitting *Group No. One Oil Corp.* v. *Bass*, 283 U. S. 279), are not progressive to acceptance of the State rule of property in determining the liability to tax, because (R., p. 125);

> "It is obvious that each of these decisions turned upon the fundamental question whether the property sought to be taxed came within the purview of the taxing statutes."

However, such precise fundamental question is the gravamen of this case, and the lower court—like the Board in its decision of this case—labors in a former twilight of tax decisions, now lifted by this Court. Such zone of error has arisen by acceptance of denials of certiorari as being a contradiction or modification of previous decisions of this Court; notwithstanding, this Court has repeatedly declared a denial of certiorari does not have such effect (*United States* v. *Carver*, 260 U. S. 482; *Atlantic C. L. Co.* v. *Powe*, 283 U. S. 401), and expresses no opinion upon the merits of said cases.

In other words, a supposed Federal rule of property, instead of the State rule of property, was reared by the Board as decisive herein of the taxability of the purchase money payments, and previously such

supposed Federal rule affected the decision of the Circuit Judge in the West Virginia litigation of petitioner Company (R., p. 50). The lower Court restates and relies upon such Federal rule herein as being established by numerous denials of certiorari (R., p. 123). The announcement of said Federal rule, as in disregard of the State rule of property, made in May, 1929, in *Hirschi* v. *United States*, 67 Ct. Cl. 637 (Cert. denied, 280 U. S. 576), holding a sale of mineral in place under the Texas property rule is not given effect under the Federal tax laws, is quoted (R., p. 51) in the Board opinion as follows:

> "The Federal Government is not limited in its selection of subjects for taxation by the construction of the State courts as to the property rights of individuals, provided the subject taxed was primarily a proper subject for taxation. *Congress in passing a revenue act does not, and is not called upon to suit the revenue system of the country to the varying and conflicting decisions and laws of the different States.*" (Italics supplied.)

This Federal rule of property found support in *Berg v. Commissioner*, 33 F. (2d) 641 (Cert. denied, 280 U. S. 598), decided in June, 1929, and in the earlier decision of *Rosenberger* v. *McCaughn*, 25 F. (2d) 699, (C. C. A. 3) (Cert. denied, 278 U. S. 604). The Board decision in January, 1930, and its affirmance by the lower Court in January, 1932, are thus but additional expressions of such rule.

We may say each precedent relied upon by the Board had previously become final, and the Federal rule

seemed established, but that this Court had repudiated the rule before the lower Court adopted and reaffirmed the rule.

After the Board decision, in November, 1930, this Court definitely struck the rule down in *Poe, Collector* v. *Seaborn,* 282 U. S. 101, 117, saying:

> "Finally, the argument is pressed upon us that the Commissioner's ruling will work uniformity of incidence and operation of the tax in the various States, while the view urged by the taxpayer will make the tax fall unevenly on married people. * * * The answer to such argument, however, is that the constitutional requirement of uniformity is not intrinsic, but geographic. *Billings* v. *United States,* 232 U. S. 261; *Head Money Cases,* 112 U. S. 580; *Knowlton* v. *Moore,* 178 U. S. 41. And differences of State law, which may bring a person within or without the category designated by Congress as taxable may not be read into the Revenue Act to spell out a lack of uniformity. *Florida* v. *Mellon,* 273 U. S. 12."

Again, this Court struck the Federal rule down, and relied upon the State rule, in the income tax of *Phillips v. Commissioner,* 283 U. S. 589, decided in May, 1931. The State rule of sale in place found full effect in April, 1931, in the income tax case, *Group No. One Oil Corp.* v. *Bass,* 283 U. S. 279. The State rule of property, in the excise tax cases of *Tyler* v. *United States,* 281 U. S. 497, decided in May, 1930, and in *Crooks* v. *Harrelson,* 282 U. S. 55, decided in November, 1930, is upheld.

Thus, any zone of error and uncertainty existing when the Board decided these cases in January, 1930, was removed by decisions of this Court before the lower Court rendered its opinion in January, 1932.

In its decision of *Crooks* v. *Harrelson* (*supra*), this Court (p. 63), expressly disapproved *Steedman* v. *United States*, 63 Ct. Cl. 226 (Cert. denied 275 U. S. 528), upon which the Hirschi decision is substantially rested by the Court of Claims.

Federal observance of the State rules of property if the ownership of property is to be determined, springs from early decisions of this Court (*McCormick* v. *Sullivant*, 10 Wheat. 192, 202; *United States* v. *Fox*, 4 Otto 315), and is precisely reflected in later decisions under the Revenue Acts (*Poe* v. *Seaborn*, 282 U. S. 101; *Group No. One Oil Corp.* v. *Bass*, *supra*).

Only two cases, as the result of denials of certiorari, stand in the way of the uniform application of the State rule of property in cases of sales of mineral in place. They are *Hirschi* v. *United States*, 67 Ct. Cl. 637 (Cert. denied 280 U. S. 576), and *Rosenberger* v. *McCaughn*, 25 F. (2d) 699 (C. C. A. 3) (Certiorari denied 278 U. S. 604).

In *Crooks* v. *Harrelson*, this Court has expressly disapproved *Steedman* v. *United States*, 63 Ct. Cl. 226 (Cert. denied 275 U. S. 528), upon which the Court of Claims substantially rested the Hirschi decision.

*Hirschi* v. *United States* and *Rosenberger* v. *McCaughn*, are now in effect disapproved by *Group No. One Oil Corp.* v. *Bass* as decided in this Court.

The conclusion of *Rosenberger* v. *McCaughn* reaffirmed by the lower Court herein:

> "that the rules of decision laid down by the State courts with regard to property, while, generally controlling upon the Federal courts, do not necessarily govern those courts in the interpretation of the laws of Congress"—,

as derived from earlier tax decisions of this Court requires some explanation. It rests upon a review by the lower Court of earlier decisions of this Court, and which decisions, we submit, are inapplicable to the present case.

*Strattons Independence v. Howbert,* 231 U. S. 399, arose before the Sixteenth Amendment, and decided the Excise Tax of 1909, upon the conduct of a business in a corporate capacity, which measured the tax by the corporate income, was applicable to corporate gains from operating mines as derived from a business of "transmitting a part of the realty into personalty and putting it into marketable form."

*Von Baumbach* v. *Sargent Land Co.,* 242 U. S. 503, involved the same Excise Tax of 1909. It was held the taxpayer was a corporate lessor under the laws of Minnesota, receiving payments which were:

> "not in substance the proceeds of an outright sale of mining property, but, in view of the terms of these instruments were in fact rents or royalties * * * within the term 'income' as intended to be reached and taxed under the terms of the Corporation Tax Act,"

was not entitled to any depletion thereon, and that it was unnecessary to determine whether the established law of the State should be followed in considering the Corporation Tax Act.

*Stanton* v. *Baltic Mining Co.*, 240 U. S. 103, decided that pursuant to the Sixteenth Amendment an income tax upon income of a corporation derived from mining operations upon its own lands is essentially the same as the income tax imposed upon corporations engaged in other business.

*United States* v. *Biwabik Mining Co.*, 247 U. S. 116, again involved the Excise Tax of 1909, and decided a corporate lessee, upon authority of the Von Baumbach case, is in no sense a purchaser of ore in place, and is not entitled to any depletion.

*Lynch* v. *Allworth Stevens Co.*, 267 U. S. 364, involved the Revenue Act of 1916 and held the lessor and lessee each had a depletable interest in mineral being mined, which was deductible from gross income under a provision of said Act authorizing the deduction to compensate for property exhaustion.

The *Baltic Mining Company* decision must be read in connection with *Brushaber* v. *Union Pacific R. Co.*, 240 U. S. 1, in considering its statement that:

> "independently of the effect on the operation of the Sixteenth Amendment, it was settled in *Strattons Independence* v. *Howbert* that such tax is not a tax upon property as such because of its ownership, but a true excise levied on the results of the business of carrying on mining operations."

In the *Brushaber* case (pp. 16, 17) we read:

> "* * * The conclusion reached in the *Pollock* case did not in any degree involve holding that income taxes generally and necessarily came within the class of direct taxes upon prop-

> erty, but, on the contrary, recognized the fact that taxation on income was in its nature an excise entitled to be enforced as such unless and until it was concluded that to enforce it would amount to accomplishing the result which the requirement as to apportionment of direct taxation was adopted to prevent, in which case the duty would arise to disregard form and consider substance alone, and hence subject the tax to the regulation as to apportionment which otherwise as an excise would not apply to it. * * *"

This conception of income tax has been clarified in *Bromley* v. *McCaughn*, 280 U. S. 124, 136, as follows:

> "While taxes levied upon and collected from persons because of their general ownership of property may be taken to be direct (*Pollock* case, 157 U. S. 429), this Court has consistently held, almost from the foundation of the Government, that a tax imposed upon a particular use of property, or the exercise of a single power over property incidental to ownership is an excise which need not be apportioned, * * *."

Now, herein petitioner Company never owned any coal nor any interest in same, and is not within any of the cases cited in that respect. Petitioner Company has never been in the mining business; its predecessor sold the coal which thereby became and is the property of the operating company, whose income therefrom is taxable under the rule of the *Baltic Mining Company* case. Petitioner Company is not an owner of coal, nor a lessor thereof, and its receipts are not derived from

"transmitting * * * realty into personalty" as said in *Stratton's Independence* v. *Howbert.* Said income flows from purchase money, the proceeds of a sale in place, the result of a severance of interest—represented by ownership of the right to collect said sale proceeds when subsequently paid.

If the income tax upon all corporations is *"a true excise on the business of carrying on —— operations"* (quoting from the *Baltic Mining Company* opinion and deleting *"mining"*), there must be some point of severance. Otherwise, the vendor of land within which coal or oil is subsequently discovered, is thereby put in the mining business through the mere subsequent collection of the purchase price although he may not of right require the property to be mined nor control its use in any way.

In *Stratton's Independence,* this Court indicates the limit of the doctrine by saying:

> "The sale outright of a mining property might fairly be described as a mere conversion of the capital from land into money."

Such outright sale being here admitted, and transfer of ownership being thereby obtained and a conversion of property being effected, the relation of the income tax to the new asset—to the contract right to the proceeds of sale—is the remaining question.

Therefore, all attempt to consider the vendor or his assignee in the mining business by reference to the foregoing decisions of this Court is without application.

The Revenue Acts lay a tax upon the net income of every corporation, and, speaking of the identical provision in the case of individuals, this Court says, in *Poe, Collector,* v. *Seaborn,* 282 U. S. 101, 109:

> "The Act goes no farther, and furnishes no other standard or definition of what constitutes an individual's income. The use of the word 'of' denotes ownership. It would be a strained construction, which, in the absence of a further defintion by Congress, should impute a broader significance to in the term.
>
> "The Commissioner concedes that the answer to the question involved in the cause must be found in the provisions of the law of the State, as to a wife's ownership of interest in community property."

In other words, given the case where a sale of mineral in place has occurred under the State law, no interest in mining or its business can be attributed to the vendor or his assignor in the present case, and there is no depletable interest. The error of the rulings of the lower Court to the contrary are thus apparent and material.

**If petitioner Company is entitled to the statutory depletion allowances of a lessor, same apply to the excess of minimum payments each year over payments for coal actually mined in each year, and the entirety of such excess is not taxable income.**

The Board held, and the lower court affirmed its decision, that the excess of annual payments over

annual payments therein for coal actually mined, being a bonus payment, was taxable income not subject to the depletion allowances of a lessor. In presenting a redetermination of tax based on this ruling, the Commissioner, by counsel, voiced disagreement therewith, and stood with petitioners, contending depletion should be allowed against said excess payments. Contemporaneously therewith, the Commissioner, by cross-appeal in *Murphy Oil Co.* v. *Commissioner*, 55 F. (2d) 17 (C. C. A. 9), sought to and did sustain his position that the Board was wrong in so holding in the case of a lessee. The wrong to a lessee so established adjudges existence of the same error of omission in the case of the alleged lessor herein.

The materiality of the error is threefold: *First*, The special statutory provision allowing depletion to the owners of interests in mining property reasonably applies to all payments made for any interest in said property, where bonus, excess of minimum, or usual payment per ton mined. *Second*—The present value of the typical contract, or all the contracts herein, rests upon giving effect to the minimum payment; the Commissioner rests the 3.6 cent allowance per ton upon assumption of 14,000,000 tons minable at 350,000 tons per year, indicating a useful life of 40 years with annual income of $34,000. After 40 years, the receipts equal $1,360,000, of which the present worth on March 1, 1913, is $510,000, and this divided by 14,000,000 tons, gives 3.6 cents per ton. Allowance of this amount only upon tonnage mined is improper in that, for example,

if $34,000 is received in a taxable year but only $17,000 of coal is mined, then an additional $17,000 is received without depletion. Thus petitioner Company is really allowed 1.8 cents instead of 3.6 cents, in the example, upon the $34,000 payment which entered into the computation of the 3.6 cent unit rate. If $68,000 is received and $17,000 is mined, petitioner Company has a 0.9 cent rate instead of 3.6 cents. *Third*—If petitioner Company receives $200 as a 10 cent payment per ton on 2,000 tons, but only 1,000 tons were mined the decision below says its depletion is 1,000 x 3.6 cents, or $36.00, and is not 2,000 x 3.6 cents, or $72.00. The schedules in the Board findings as to Leases 2 and 4 (Petition for Reargument, R., p. 160), show in the seven years here in controversy, petitioner Company is deprived of $72,000 of depletion upon an excess of 2,000,000 tons paid for but not mined, and is required to taxpay said amount.

Article 216, Regulations 69 (appendix), presents the proper and reasonable method of computing and applying the deduction, as said in *Murphy Oil Co., supra:*

> * * * "by assuming that the bonus contains the same element of profit of income to the landlord that would be derived from the sale of oil recovered as royalty."
>
> "The regulation is not only not in conflict with the statute, but directly conforms thereto."

By narrow interpretation it might well be said no question of bonus is adequately present in these cases, for Article 216 contemplates "a bonus in addition to

royalties", while herein the "royalties" are dubbed "bonus" when they exceed the payments for coal mined. As the royalties enter into the computation of the depletion allowance, such allowance reasonably is deductible from all subsequent royalty receipts whether all the coal thereby paid for is mined in the year of payment.

Petitioners urge that the Board decision and its blanket affirmance by the lower Court are in error, that the Commissioner gave effect to the proper computation in Article 216 (*supra*) and obtained approval thereof in *Murphy Oil Co.* v. *Commissioner, supra,* and that, if pertinent, the depletion allowance herein should be so computed, and the lower Court reversed.

**The res adjudicata herein against the Commissioner, upon the depletion issue, of a judgment involving said issue and obtained by petitioner Company in a prior action against a Collector, whom therein the Commissioner defended of record.**

Before the Board, petitioner Company pleaded the District Court judgment obtained against the Collector and paid by the United States as *res adjudicata* herein of any depletion rate allowable to a lessor in its position, and the Commissioner did not answer. The Board received the record and judgment in evidence as merely persuasive and not conclusive (R., p. 103), to which ruling petitioner Company excepted, It appeared no changes or alterations in the original sale contracts, and no new contracts, had been made since the institution of the prior litigation (R., p. 101).

The Board made finding of fact as to the nature and result of the prior litigation (R., p. 47), but its opinion states no conclusion thereon. The lower Court, reviewing the facts, held the West Virginia judgment was not *res adjudicata* against the Commissioner of Internal Revenue (R., p. 126), saying:

> "The rule (*res adjudicata*) is applicable, however, only when the subsequent suit is between the same parties or their privies. The taxpayer maintains that we have that situation in the present litigation because the United States in reality is its opponent in both cases, being represented by the Collector of Internal Revenue in the prior suit, and by the Commissioner of Internal Revenue now. But the argument is refuted by the decision in *Sage* v. *United States*, 250 U. S. 33, where it was expressly ruled, against the protest of the government, that the court was not bound by a judgment in a former suit concerning the same subject matter between the taxpayer and a Collector of Internal Revenue because a suit against a collector of Internal Revenue is personal and its incidents, such as the nature of the defenses open and the allowance of interest, are different. This ruling has recently been cited with approval by the Supreme Court in *Graham & Foster* v. *Goodcell*, 282 U. S. 409, 430. The decision of the District Court for the Southern District of West Virginia was therefore not binding upon the Commissioner, and he had the authority to determine anew, as a question of fact, what allowance should be made for the depletion of the mine."

Petitioners submit the determination of the judgment against the Collector in the prior litigation that a 5 cent depletion rate was allowable to petitioner Company is effective as a final determination of the depletion issue in these proceedings against the Commissioner of Internal Revenue from four viewpoints.

*Privity of Record.*—Although the action of taxpayer against collector to recover income tax is personal in its character or unique in its attributes, either the United States or the Commissioner of Internal Revenue, or both, may by their acts become bound by a judgment in favor of the taxpayer in said action.

The findings of facts herein (R., p. 47) are:

> * * * "said judgment was duly paid by the United States. In said action the Bankers Pocahontas Coal Co., one of the petitioners herein, was plaintiff; plaintiff petitioner appearing in its own right and the collector as defendant, who was defended in said action by the United States District Attorney and the Solicitor of Internal Revenue (now General Counsel). In this proceeding and in said court action the subject matter of the action and of these proceedings is the same, namely, the depletion unit allowable in computing the amount of such depletion deduction as will return to the taxpayer the capital value existing in the coal content of the corporation's property as of March 1, 1913."

The official appearance of the Solicitor of Internal Revenue who is counsel for the Commissioner of Internal Revenue, renders said Commissioner privy to said proceeding and bound by the ensuing judgment

under the rule stated in *Souffront v. LaCompagnie*, 217 U. S. 475, 487, as follows:

> "*The persons for whose benefit, to the knowledge of the court and of all the parties to the record, litigation is being conducted, cannot, in a legal sense, be said to be strangers to the cause.* The case is within the principle that one who prosecutes or defends a suit in the name of another to establish and protect his own right, *or who assists in the prosecution or defense of an action in aid of some interest of his own, and who does this openly, to the knowledge of the opposing party,* is as much bound by the judgment, and as fully entitled to avail himself of it, as an estoppel against an adversary party, as he would be if he had been a party to the record. *Lovejoy* v. *Murray*, 3 Wall. 1, 18 L. Ed. 129." (Italics supplied.)

To the same effect is *Beyer Co.* v. *Fleischman*, 15 F. (2d) 465 (C. C. A. 6) and the numerous authorities therein cited.

The Commissioner and the United States may ascertain the net amount recoverable in the ultimate and final judgment against the Collector by set off of tax legally due, and be concluded by the judgment. Thus, in *New York Life Insurance Co.* v. *Anderson*, 263 F. 530 (C. C. A. 2) such adjustment as made below is upheld upon authority of *Crocker* v. *Malley*, 249 U. S. 223, as an "*anamalous practice* * * * *required by federal authority*", and as "*based on a spirit of convenience*". In *Crocker* v. *Malley, supra*, decided in 1919 and cited by Mr. Justice Holmes in the *Sage* case (p. 37) opinion, he says:

"The district court, while it found for the plaintiffs, ruled that the defendant was entitled to retain out of the sum received by him the amount of the tax that they should have paid as trustees. To this the plaintiffs took a cross writ of error to the circuit court of appeals. There can be no question that, although the plaintiffs escape the larger liability, there was probable cause for the defendant's act. The Commissioner of Internal Revenue rejected the plaintiff's claim, and the statute does not leave the matter clear. The recovery, therefore, will be from the United States. Rev. Stat., Par. 989, Comp. Stat. 1916, Par. 1635. The plaintiffs, as they themselves alleged in their claim, were the persons taxed, whether they were called an association or trustees. They were taxed too much. *If the United States retains from the amount received by it the amount that it should have received, it cannot recover that sum in a subsequent suit.*" (Italics supplied.)

In *City of New Orleans* v. *Citizens Bank,* 167 U. S. 371; *Baldwin* v. *Maryland,* 179 U. S. 220, and *Gunter* v. *Atlantic C. L. R. Co.,* 200 U. S. 273, it is held that the general rule of law by which a judgment estops the parties in future litigation between them, to question either a fact or point of law necessary to the first judgment and adjudicated therein, applies to cases of taxation as well as to other subjects of litigation. In *United States* v. *Stone and Downer Co.,* 274 U. S. 225, 230, 233, 237, after recognizing said general rule, this Court says same does not apply to litigation in the Court of Customs Appeals. Very properly the same exception is available to the Board of Tax Appeals,

whereby the termination of a prior controversy there arising is not conclusive upon the same subject matter between the parties in a subsequent proceeding.

But extension of the rule in exclusion of determinations arising and obtained in the courts impinges upon and contradicts the general rule. If the "*spirit of convenience*" produces "*an anamalous practice required by federal authority*", it follows the open participation of the Commissioner in defending the Collector leaves the Commissioner bound by the results obtained and prevents him from contesting the same subject matter in later proceedings.

*Official Privity.*—Aside from the privity resulting from active defense of the Collector, there is sufficient official and statutory relationship to establish privity on that ground.

There is a privity of duty between the Collector and Commissioner, notwithstanding they are separate officers, appointed by the President (R. S. 319, 3142); the Commissioner has general charge of the assessment and collection of taxes (R. S. 321), remits, refunds and pays back taxes illegally or erroneously collected, and repays the Collector adjudged tax recoveries with the costs and expenses of suit (R. S. 3220); his discretion is not reviewable by any other officer of the Government (*Kaufman's* case, 96 U. S. 568) and he may satisfy a judgment against a Collector without issue of a certificate of probable cause (*United States* v. *Frerichs,* 124 U. S. 315; the Collector gives bond in the amount prescribed by the Commissioner (R. S. 3143), sues for the recovery of taxes in the name of the United States when authorized to do so by the Com-

missioner (R. S. 3213, 3214). A taxpayer may not sue a Collector to recover taxes except after previous presentation of his claim to the Commissioner (R. S. 3226). Thus both are intimately related in their official duties, the Collector being substantially the agent of the Commissioner.

*No Immunity to Commissioner.*—The pertinent Revenue Acts merely provide that where the Commissioner determines a deficiency of tax "the taxpayer may file a petition with the Board of Tax Appeals for redetermination of the deficiency" (Rev. Act of 1926, 274(*a*)). This Court said in *Blair* v. *Oesterlein Mach. Co.*, 275 U. S. 220, 227 of the Board's ensuing authority:

> "It may investigate anew the issues between the government and the taxpayer and upon the determination of the appeal it may affirm, set aside or modify the findings and decision of the Commissioner."

This Court has further said the decision of the Board may be reviewed in the Circuit Courts of Appeals and herein (*Old Colony Trust Co.* v. *Commissioner*, 279 U. S. 716, 721).

Thus the Revenue Acts afford taxpayer another remedy, in addition to the taxpayer's right of action after payment of a Federal tax for recovery of same previously existing against either the Collector of Internal Revenue or the United States. It does not follow there is any immunity to the Commissioner of Internal Revenue.

Any immunity of the sovereign claimed by its agent must be established by production of a law, which com-

missions the party claiming the immunity and warrants the act sought to be avoided (*Poindexter* v. *Greenhow,* 114 U. S. 270, 288), but no such law is produced herein, for none exists.

In the *Poindexter* opinion, *supra* (p. 288), we read:

> "The *ratio decidendi* in this class of cases is very plain. A defendant sued as a wrongdoer, who seeks to substitute the state in his place, or to defend on the ground that the state has adopted his act and exonerated him, cannot rest on the bare assertion of his defense. He is bound to establish it. The state is a political corporate body, can act only through agents, and can command only by laws. It is necessary, therefore, for such a defendant, in order to complete his defense, to produce a law of the state which constitutes his commission as its agent, and a warrant for his act."

The Commissioner, as respondent before the Board as in subsequent proceedings, cannot invoke the immunity of the United States (*United States* v. *Lee,* 106 U. S. 196; *Trudal* v. *Wesley,* 167 U. S. 204, 222; *Scranton* v. *Wheeler,* 179 U. S. 141, 153).

*No Immunity to the United States.*—This viewpoint has reference to the effect of the proceedings mentioned in the *Sage* case as subsequent to the judgment, whereby, upon issue by the trial court of the certificate of probable cause under R. S. 989, payment of the judgment is made by the United States. The effect of the issue of the certificate of probable cause is declared in *United States* v. *Sherman,* 98 U. S. 565, 567.

> "When the certificate is given the claim of the plaintiff in the suit is practically converted

> into a claim against the government. But not until then."

The final judgment contemplated by R. S. 989 is defined in *Schell* v. *Cochran*, 107 U. S. 625, with approval therein of the *Sherman* decision.

A claim against the Government, which it subsequently has paid, being so established by statutory authority, it reasonably follows that the Government had adopted the judgment in all its implications and findings, and is bound by same. This recognizes the principle that the Government may not be sued without its consent (*Carr* v. *United States*, 98 U. S. 433), and yet gives effect either to R. S. 989 wherein the Government authorizes the trial court to impose the individual liability of its officer upon the Government, or to R. S. 3220, whereby the Commissioner makes the judgment binding upon the Government by an award thereon to the taxpayer without previous issue of the certificate of probable cause (*United States* v. *Frerichs*, 124 U. S. 315, 319). Said effect is declared in *N. Y. C. & H. R. R. Co.* v. *United States*, 24 Ct. Cl. 22, 29:

> "It is impossible to suppose that the law intends to allow an action to be prosecuted against a public officer, an appeal to be taken, a defense to be maintained by the Government through its proper law officers, a judgment to be recovered under the direction of our highest judicial authority, and the right thus acquired to be immediately taken away by a certificate resting upon the discretion of a single judge, upon an issue not tried by a jury, and allowed by an order from which there is no appeal, unless it

> likewise intends that the absolute discharge of the agent shall operate as an assumption of the debt by the principal."

In other words, the Government upon issue of the certificate of probable cause takes over and assumes the obligations of the agent, whereby the conclusive effect of the judgment may become available to the taxpayer in subsequent litigation on the same subject matter under the theory of *Crocker* v. *Malley, supra.* It does not appear whether this aspect was presented in the *Sage* case, except the opinion almost reaches the proposition and turns abruptly to the facts in that case, to say:

> "But perhaps it would be enough to say that if the judgment otherwise were a bar, the bar would be removed by the subsequent enactment of the Act of July 27, 1912, upon which, as well as upon the Act of 1902, this claim is based."

In *Second National Bank of Saginaw* v. *Woodworth, Collector,* 54 F. (2) 672, an action of taxpayer brought against the United States for recovery of taxes in the Court of Claims being ordered dismissed, the Collector is held entitled to rely on said order as an estoppel and *res adjudicata.* The decision is rested upon the test of privity whereby, unless the Collector may so defend, the United States might through a certificate of probable cause be obligated for a demand previously litigated and defeated in an action against the Government. But the alleged privity herein leads to no such illogical situation, whereas it is equally illogical that although the Government may not by indirection be

made liable for a claim it has previously defeated, the taxpayer may be made liable for a claim which it has previously defeated.

The finality of Board proceedings after judicial review thereof as declared by the Revenue Act of 1926, *Section 283(b)*, is held available to a Collector in *Greylock Mills* v. *White*, 55 F. (2) 704, and the finality of a judgment adopted and satisfied under a statutory certificate of probable cause should be equally available to the taxpayer in a subsequent controversy with the Commissioner as to the same subject matter.

For these reasons, the refusal of the lower Court to give effect herein, if applicable, to the depletion rate previously adjudged in litigation against the Collector is presented as error.

**The Strother Relief.**

It was stipulated below that the decision of the case of petitioner Company should adjudicate the case of petitioner Strother. The lower Court directed supplemental proceedings before the Board should be had to ascertain his possible tax liability. The propriety of the relief so granted is not open to challenge herein because the Commissioner of Internal Revenue neither applied for nor obtained a writ of certiorari in reference thereto. *Lucas* v. *Alexander*, 279 U. S. 573.

**Conclusion.**

It is respectfully submitted the lower Court should be reversed herein for cause:

That it erred in refusing to hold the contract proceeds from the sale in place received by petitioner

Company were not taxable income in the years in controversy.

That it erred in holding Congress intended by the Revenue Acts to tax same as the receipts of a lessor.

That it erred, if it appear in the alternative said proceeds are taxable as receipts of a lessor, in neither allowing a rate of 5 cents per ton adjudicated to petitioner Company in prior litigation, nor in allowing depletion upon payments in excess of coal actually mined and paid for in the taxable periods.

And petitioners abide the decision of the Court.

Respectfully,

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## APPENDIX.

### Constitution, Statutes and Regulations Involved.

### The Constitution of the United States.

Amendment Sixteen (effective March 1, 1913). The Congress shall have power to lay and collect taxes on incomes from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

### Individual Gross Income.

Revenue Act of 1918, Section 213 (40 Stat. 1057-96, C. 18):

> "That for the purposes of this title (except as otherwise provided in section 233) the term 'gross income'—
>
> "(*a*) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever."

Revenue Act of 1921, Section 213 (same as above). (42 Stat. 227, C. 136.)

Revenue Act of 1924, Section 213 (same as Revenue Act of 1918 above). (43 Stat. 253, C. 234.)

Revenue Act of 1926, Section 213 (same as Revenue Act of 1918 above). (44 Stat. (Part 2) 9, C. 27.)

**Individual Net Income.**

Revenue Act of 1918, Section 212 (*Idem.*):

> "That in the case of an individual the term 'net income' means the gross income as defined in section 213, less the deductions allowed by section 214."

Revenue Act of 1921, Section 212 (same as Revenue Act of 1918 above). (*Idem.*)

Revenue Act of 1924, Section 212 (same as Revenue Act of 1918 above). (*Idem.*)

Revenue Act of 1926, Section 212 (same as Revenue Act of 1918 above). (*Idem.*)

**Corporation Gross Income.**

Revenue Act of 1918, Section 233 (*Idem.*):

> "That in the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in section 213, except that:" (Exceptions not material.)

Revenue Act of 1921, Section 233 (*Idem.*):

> "That in the case of a corporation subject to the tax imposed by section 230 the term 'gross income' means the gross income as defined in sections 213 and 217, * * *." (Not material here.)

Revenue Act of 1924, Section 233 (same as Revenue Act of 1921 above). (*Idem.*)

Revenue Act of 1926, Section 233 (same as Revenue Act of 1921 above). (*Idem.*)

**Corporation Net Income.**

Revenue Act of 1918, Section 232 (*Idem.*):

> "That in the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233 less the deductions allowed by section 234, and the net income shall be computed on the same basis as is provided in subdivision (*b*) of section 212 or in section 226." (Omitted as relating only to accounting method.)

Revenue Act of 1921, Section 232 (*Idem.*):

> "That in the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233, less the deductions allowed by section 234."

Revenue Act of 1924, Section 232 (same as Revenue Act of 1921 above). (*Idem.*)

Revenue Act of 1926, Section 232 (same as Revenue Act of 1921 above). (*Idem.*)

**Meaning of Net Income.**

Article 21 (Reg. 45, years 1918, 1919, 1920) (Reg. 62, years 1921, 1922, 1923) (Reg. 65, year 1924) (Reg. 69, years 1925, 1926):

> "The tax imposed by the statute is upon income. In the computation of the tax various classes of income must be considered:
>
> "(*a*) Income (in the broad sense), meaning all wealth which flows in to the taxpayer other than as a mere return of capital. It includes the

forms of income specifically described as gains and profits, including gains derived from the sale or other disposition of capital assets. Cash receipts alone do not always accurately reflect income, for the statute recognizes as income-determining factors other items, among which are inventories, accounts receivable, property exhaustion, and accounts payable for expenses incurred. * * *

"(*b*) Gross income, meaning income (in the broad sense) less income which is by statutory provision or otherwise exempt from the tax imposed by the statute. * * *

"(*c*) Net income, meaning gross income less statutory deductions. The statutory deductions are in general, though not exclusively, expenditures, other than capital expenditures, connected with the production of income. * * *

"(*d*) Net income less credits. * * *

"The surtax is imposed upon net income; the normal tax upon net income less credits. Although taxable net income is a statutory conception, it follows, subject to certain modifications as to exemptions and as to deductions for partial losses in some cases, the lines of commercial usage. Subject to these modifications statutory 'net income' is commercial 'net income'. This appears from the fact that ordinarily it is to be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer. As to the net income of corporations, see section 232 * * * and article 531."

Article 531 (same Regulations):

"*Net Income.*—Net income is that portion of the gross income which remains after all proper

deductions have been taken into account. The net income of corporations is determined in general in the same manner as the net income of individuals, but the deductions allowed corporations are not precisely the same as those allowed individuals. * * * The net income of corporations is to be computed on the same basis as to accounting periods as the net income of individuals."

Article 90 (same Regulations):

"*Income Accrued Prior to March 1, 1913.*—Any claim existing unconditionally on March 1, 1913, whether presently payable or not, and held by a taxpayer prior to March 1, 1913, whether evidenced by writing or not, and all interest which had accrued thereon before that date, do not constitute taxable income, although actually recovered or received subsequent to such date. Interest accruing on or after that date is taxable income. Where an interest-bearing claim held on February 28, 1913, is paid in whole or in part after that date, any gain derived from the payment of the claim is taxable. The amount of such gain is the excess of the proceeds of the claim (both principal and interest) exclusive of any interest accrued since February 28, 1913, already returned as income, over the cost thereof (both principal and interest then accrued). However, the gain to be included in gross income where the fair market value of the claim as of March 1, 1913, is greater than the cost thereof, is the excess of the amount received over such value. In the case of an insurance policy its surrender value as of March 1, 1913, may be used as a basis for

the purpose of ascertaining the gain derived from its sale or other disposition. Where services were rendered prior to March 1, 1913, but paid for thereafter, the amount received is taxable income to the extent of the excess of such amount over the fair market value on March 1, 1913, of the principal of the claim and any interest which had then accrued."

**Corporation Deductions.**

Revenue Act of 1918, Section 234:

"That in computing the net income of a corporation subject to the tax imposed by Section 230, there shall be allowed as deductions: * * *

"(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost, including cost of development not otherwise deducted: *Provided,* that in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: * * * In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee."

Revenue Act of 1921, Section 234 (same as Revenue Act of 1918 above) (*Idem.*).

Revenue Act of 1924, Section 234 (same as Revenue Act of 1918 above) (*Idem.*).

Revenue Act of 1926, Section 234 (same as Revenue Act of 1918 above) (*Idem.*).

Article 204 (same Regulations as above):

"*Amount Returnable Through Depletion and Depreciation in the Case of Lessor.*—(*a*) In the case of a lessor, the amount remaining in any year returnable through depletion and depreciation deductions is (1) the value of his equity in the property at the basic date minus (2) depletion and depreciation sustained, whether legally allowable or not, from the basic date to the taxable year, plus (3) subsequent allowable capital additions, and minus (4) the value of the land at the basic date for other purposes than mineral production and the residual value of other property at the end of operations. The amount returnable through depletion is the total capital remaining less the sum recoverable through depreciation. The provisions of this paragraph do not apply to the computation of the depletion allowance in the case of oil and gas wells when such allowance is based on the income from the property.

"(*b*) The values of the equities of lessor and lessee shall be computed separately, but, when determined as of the same basic date, shall together never exceed the value at that date of the property in fee simple. * * *

"(*d*) The value of the lessor's equity in a mineral property under lease March 1, 1913, for the entire operating life of the mineral deposits is to be taken to mean (1) the cost or (2) the value as of March 1, 1913, of the royalties and other payments to be expected under the terms of the lease in effect on that date, whichever is greater."

Article 215 (Regulations 45, 62, 65 above):

"*Depletion-Adjustments of Accounts on Bonus or Advanced Royalties.*—(*a*) Where a

lessor receives a bonus or other sum in addition to royalties, such bonus or other sum shall be regarded as a return of capital to the lessor, but only to the extent of the capital remaining to be recovered through depletion by the lessor at the date of lease. If the bonus exceeds the capital remaining to be recovered, the excess and all the royalties thereafter received will be income and not depletable. If the bonus is less than the capital remaining to be recovered by the lessor through depletion, the difference may be recovered through depletion deductions based on the royalties thereafter received. The bonus or other sum paid by the lessee for a lease made on or after March 1, 1913, will be his value for depletion as of date of acquisition."

Article 216 (215) (Regulations 69 above amending Article 215):

"*Depletion-Adjustments of Accounts Based on Bonus or Advanced Royalty.*—(*a*) Where a lessor receives a bonus in addition to royalties, there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the amount remaining to be recovered by the lessor through depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received."

**Dividends.**

Revenue Act of 1918, Section 201 (*Idem.*):

"(*a*) That the term 'dividend' when used in this title (except in paragraph (10) of subdivision (*a*) of section 234) means (1) any distribution made by a corporation, other than a personal service corporation, to its shareholders or members, whether in cash or in other property or in stock of the corporation, out of its earnings or profits accumulated since February 28, 1913 * * *.

"(*b*) Any distribution shall be deemed to have been made from earnings or profits unless all earnings and profits have first been distributed. * * *

"(*c*) Any distribution made during the first sixty days of any taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any distribution made during the remainder of the taxable year shall be deemed to have been made from earnings or profits accumulated between the close of the preceding taxable year and the date of distribution, to the extent of such earnings or profits, and if the books of the corporation do not show the amount of such earnings or profits, the earnings or profits for the accounting period within which the distribution was made shall be deemed to have been accumulated ratably during such period."

Revenue Act of 1921, Section 201 (*Idem.*):

"(*a*) That the term 'dividend' when used in this title (except in paragraph (10) of subdivi-

sion (*a*) of section 234 and paragraph (4) of subdivision (*a*) of section 245) means any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 28, 1913. * * *

"(*b*) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed. * * *

"(*f*) Any distribution made during the first sixty days of any taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any distribution made during the remainder of the taxable year shall be deemed to have been made from earnings or profits accumulated between the close of the preceding taxable year and the date of distribution, to the extent of such earnings and profits, and if the books of the corporation do not show the amount of such earnings or profits, the earnings or profits for the accounting period within which the distribution was made shall be deemed to have been accumulated ratably during such period. This subdivision shall not be in effect after December 31, 1921."

Revenue Act of 1924, Section 201 (same as Revenue Act of 1921 above). (*Idem.*)

Revenue Act of 1926, Section 201 (same as Revenue Act of 1921 above). (*Idem.*)

Article 1542, (Same Regulations):

> "*Source of Distribution.*—For the purpose of income taxation every distribution made by a corporation is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits."

Article 1543, (same Regulations):

> "*Distribution Out of Earnings or Profits Accumulated Prior to March 1, 1913.*—Any distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of increase in value of property accrued prior to March 1, 1913 (whether or not realized by sale or other disposition prior to or on or after March 1, 1913) is not a dividend within the meaning of Title II. The provisions of the preceding sentence shall be applied uniformly to cases arising under the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, the Revenue Act of 1921, and the Revenue Act of 1924, as well as the Revenue Act of 1926. A corporation cannot distribute earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, exempt from tax, unless and until all earnings or profits accumulated since February 28, 1913, have been distributed. * * *
>
> "In determining whether a dividend is out of earnings or profits accumulated since February 28, 1913, or prior to March 1, 1913, due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive. * * *"

Article 1546, (Same Regulations):

> "*Distributions from Depletion or Depreciation Reserves.*—A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of surplus out of which ordinary dividends may be paid. * * * No distribution, however, can be made from such a reserve until all the earnings or profits of the corporation have first been distributed."

**Certificate of Probable Cause.**

R. S. 989 (12 St. L. 741, c. 76, 12):

> "When a recovery is had in any suit or proceeding against a collector or other officer of the revenue for any act done by him, or for the recovery of any money exacted by or paid to him and by him paid into the Treasury, in the performance of his official duty, and the Court certifies that there was probable cause for the act done by the collector or other officer, or that he acted under the directions of the Secretary of the Treasury, or other proper officer of the Government, no execution shall issue against such collector or other officer, but the amount so recovered shall, upon final judgment, be provided for and paid out of the proper appropriation from the Treasury."

**Refunding Taxes and Penalties Including Judgments.**

R. S. 3220 (14 St. L. 111, C. 184, 9; 17 St. L. 401, C. 13, 1; 40 St. L. 1145, C. 18, 1316(*a*); 44 St. L. 115, C. 27, 1111; 45 St. L. 878, C. 852, 619; 45 St. L. 996, C. 901, 3.

"Except as otherwise provided by law in the case of income, war-profits, excess-profits, estate, and gift taxes, the Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, is authorized to remit, refund, and pay back all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that appear to be unjustly assessed or excessive in amount, or in any manner wrongfully collected; also to repay to any collector or deputy collector the full amount of such sums of money as may be recovered against him in any court, for any internal-revenue taxes collected by him, with the cost and expense of suit; also all damages and cost recovered against any assessor, assistant assessor, collector, deputy collector, agent, or inspector, in any suit brought against him by reason of anything done in the due performance of his official duty, and shall make report to Congress, by internal-revenue districts and alphabetically arranged of all refunds in excess of $500, at the beginning of each regular session of Congress of all transactions under this section."